LIBRARY
SUPREME COURT, U.S.

Supreme Court, U.S.
FILED
MAR 8 1971
E. ROBERT SEAVER, CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1970

70-79

No. ~~1332~~

RELIANCE ELECTRIC COMPANY,
Petitioner,

v.

EMERSON ELECTRIC COMPANY,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

BRIEF FOR RESPONDENT IN OPPOSITION

R. H. McROBERTS
THOMAS C. WALSH
1600 Boatmen's Bank Building
St. Louis, Missouri 63102
Attorneys for Respondent

BRYAN, CAVE, McPHEETERS & McROBERTS
Of Counsel

St. Louis Law Printing Co., Inc., 411-15 N. Eighth St. 63101 314-231-4477

INDEX

	Page
Opinion below	1
Questions presented	1
Statement of facts	3
Reasons why the writ should not be granted	8
Conclusion	15

CITATIONS

Cases Cited

Adler v. Klawans, 267 F. 2d 840, 845 (2d Cir. 1959) ..11, 12

Bershad v. McDonough, 428 F. 2d 693 (7th Cir. 1970) 14, 15

Blau v. Lehman, 368 U.S. 403 (1962) 14

Helvering v. Gregory, 69 F. 2d 809 (2d Cir. 1934) affirmed 293 U.S. 465 (1935) 14

United States v. Isham, 84 U.S. [17 Wall] 496 (1873) 14

Statutes Cited

15 U.S.C., § 78 ..... 3, 8

28 U.S.C., § 1292(b) 6

Securities Exchange Act of 1934:

Section 10(b) 10, 14

Section 14 8

Section 16(b) ...1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15

Miscellaneous Cited

Katz, "Short-Swing Liability" The Review of Securities Regulation, Vol. 2, No. 8 (April 16, 1969) 12

Seligman "Problems Under the Securities Exchange Act," 21 Va. L. Rev. 1, 20 (1934) 13

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1970

No. 1332

RELIANCE ELECTRIC COMPANY,
Petitioner,

v.

EMERSON ELECTRIC COMPANY,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

BRIEF FOR RESPONDENT IN OPPOSITION

OPINION BELOW

The opinion of the United States Court of Appeals for the Eighth Circuit is now reported at 434 F. 2d 918.

QUESTIONS PRESENTED

I. May a Corporation

(a) which is not an "insider" in fact,

(b) but which has become a technical "insider" under Section 16(b) of the Securities Exchange Act of 1934, by its acquisition of more than 10% of a

listed issuer's capital stock, pursuant to an unsuccessful tender offer,

(c) when such corporation finds itself about to be forced into an involuntary "sale" of such stock, within six months of its purchase, by reason of a merger of the issuer into another corporate entity,

In Good Faith Minimize the Section 16(b) Consequences of the Theatened Involuntary "Sale"

(d) by first selling sufficient stock of the issuer, in a bona-fide sale, to reduce its holdings to less than 10%, and

(e) thereby cease to be a technical "insider" under Section 16(b), and

(f) thereafter sell the remainder of its stock, in a second and unconnected bona-fide sale, free from Section 16(b) liability?

II. Does the Proviso to Section 16(b) Stating That "This Subsection Shall Not Be Construed to Cover Any Transaction Where Such Beneficial Owner Was Not [the Beneficial Owner of More Than 10 Per Centum] Both at the Time of the Purchase and Sale" Mean What It Says?

STATEMENT OF FACTS

Petitioner seeks review of the unanimous decision of the three-judge panel of the Court of Appeals for the Eighth Circuit denying recovery under the short-swing profit provisions of Section 16(b) of the Securities Exchange Act of 1934, (15 U.S.C. § 78 p (b)) for the profits realized by Respondent from the sale of stock of the issuer on September 13, 1967, at which time it is conceded that Respondent owned less than 10% of the issuer's stock. Petitioner's version of the facts is incomplete and inadequate to depict accurately the unusual circumstances out of which this case arose.

On May 22, 1967, Respondent Emerson Electric Co. ("Emerson") announced in the public and financial press an offer to purchase up to 550,000 shares of the common stock of Dodge Manufacturing Corporation ("Dodge") from Dodge shareholders. At no time prior to this tender offer did Emerson own any shares or other securities of Dodge. Dodge management vigorously contested Emerson's tender offer and urged its shareholders to reject the offer. On May 25, Dodge publicly and unexpectedly announced an agreement in principle to merge with Petitioner, Reliance Electric Company ("Reliance").

Dodge filed suit against Emerson in federal court in Indiana to prohibit Emerson from accepting any tenders or further pursuing its tender offer. In its complaint, Dodge charged Emerson, *inter alia,* with harassment, with making derogatory statements about Dodge and with misusing confidential information acquired from Dodge. The District Court refused to issue a temporary injunction and, in its Memorandum Opinion, the court specifically absolved Emerson of wrongdoing and found that Emerson did not have any confidential information about Dodge and that

all its knowledge concerning Dodge had been gleaned from publicly available sources.

On June 16, 1967, the tender offer expired, and Emerson purchased all of the shares tendered by the Dodge stockholders, totaling 152,282 shares. The shares so purchased represented 13.2% of the outstanding Dodge common stock.

Emerson then decided to make a counter-proposal, in opposition to the Reliance merger offer, that Dodge be merged into Emerson. Dodge management firmly and consistently opposed the Emerson proposal, and Emerson was eventually required to file suit to obtain the shareholders' list.

A special meeting of the Dodge shareholders was called for August 22, and a lively proxy contest ensued between Dodge and Emerson. Dodge persisted in its opposition to Emerson, and Emerson was again forced to file suit to prevent Dodge from denying Emerson access to shareholders and for making false and misleading statements about Emerson's merger proposal. At the Dodge shareholders' meeting on August 22, the Emerson plan was rejected, and the Reliance merger was approved, to become effective on or about September 30, 1967.

During the proxy contest between Emerson and Dodge, Emerson and its counsel were well aware of Section 16(b), of the fact that Emerson had, on June 16, 1967, become the holder of more than 10% of the common stock of Dodge, and of the fact that if the Dodge-Reliance merger should be consummated, Emerson would probably be considered to have "sold" these shares, within six months, for Section 16(b) purposes.

Under date of June 26, 1967, counsel gave Emerson a formal opinion discussing both tax and Section 16(b) con-

siderations arising out of Emerson's acquisition of 152,282 shares of Dodge stock. After pointing out the tax disadvantages to Emerson of realizing short-term versus long-term capital gains on any sale of such shares, counsel discussed the possible impact of Section 16(b) upon any profits which Emerson might realize and concluded that "it is important for Emerson to reduce its holdings of Dodge stock to less than 10% prior to the Dodge stockholders' meeting."

Following counsel's recommendation, Emerson, on or about August 22, 1967, initiated negotiations with Goldman, Sachs & Co. for the sale of 37,000 shares of Dodge stock. The sale, made on the New York Stock Exchange, was consummated on August 28, 1967 and reduced Emerson's holdings in Dodge to less than 10%.

On August 29, 1967, *Reliance*, on behalf of Dodge, *initiated discussions with Emerson* for the purchase by Dodge of the remaining 115,282 shares from Emerson. Prior to such time, Emerson had not offered to sell any of such shares and had made no decision to sell them. Negotiations continued and, on September 11, 1967, a comprehensive purchase agreement was entered into between Dodge and Emerson for the sale to Dodge of the 115,282 shares. The purchase agreement was consummated and closed according to its terms on September 13, 1967. On September 29, 1967, Dodge merged into Reliance, with Reliance emerging as the surviving corporation, and Dodge stockholders received shares of Reliance in exchange for their Dodge stock.

In the purchase agreement dated September 11, 1967, and several times thereafter, Reliance made the representation and expressed the opinion that the profits realized by Emerson on the sale to Dodge of the 115,282 shares on September 13, 1967 were not subject to Section 16(b) be-

cause Emerson indisputably was not then the owner of more than 10% of the Dodge stock.

After a demand by a Reliance shareholder, however, Reliance wrote to Emerson on February 13, 1968, demanding that Emerson pay to Reliance the net profits, after expenses, realized by Emerson on the sale of 37,000 shares of Dodge stock on August 28. Reliance again specifically stated that, in its opinion, the profits which Emerson made on the September 13th sale were not recoverable by Reliance, since Emerson at that time was not the owner of more than 10% of the outstanding stock of Dodge.

Emerson denied all liability under Section 16 (b) on the grounds that it did not own any Dodge stock "at the time of the purchase" of the 152,282 shares on June 16, and was thus expressly exempted from liability on either sale. Faced with this controversy, Emerson filed a complaint for a declaratory judgment in the District Court, requesting a declaration of its rights and/or obligations under Section 16(b). Reliance filed an answer and counterclaim, praying for judgment against Emerson in the total net amount of Emerson's profits not only on the sale of 37,000 shares of Dodge stock on August 28 but also on the sale of 115,282 shares of Dodge stock on September 13.

After a trial to the court on the issue of liability only, the District Court held Emerson liable for its net profits on both sales. The court concluded that Emerson should be held accountable for the profits realized on the second sale even though it expressly found that "at the time (by reason of its prior disposition of the 37,000 shares) Emerson was the beneficial owner of less than 10% of Dodge shares." Recognizing the novelty of this holding, the court certified the case for interlocutory appeal under 28 U.S.C., § 1292(b).

The Court of Appeals reversed on this issue, holding, under the peculiar facts of this case, that the statute must

be interpreted according to its clear language and that, therefore, the second and independent sale of September 13 was not made at a time when Emerson was more than a 10% stockholder of Dodge and was thus free from the proscriptions of Section 16(b).[1]

---

[1] The district court rejected Emerson's contention that it should not be held liable for any profits on either sale because it owned no Dodge stock "at the time of the purchase" of 13.2% on June 16, 1967. The Court of Appeals affirmed this holding, thus requiring Emerson to pay to Reliance the profits from the sale of 37,000 shares on August 28. Of course, if certiorari is granted, the issue will be presented as to whether Emerson was the owner of more than 10% "at the time of the purchase" as well as "at the time of the [second] sale."

REASONS WHY THE WRIT SHOULD NOT BE GRANTED

Both the District Court and the Court of Appeals recognized that this case is one of first impression. The District Court based its decision on "the peculiar facts of this case."[2] The Court of Appeals also noted that an *ad hoc* approach is necessitated by factual variations in Section 16(b) cases:

> "The factual question as to whether a particular sale is a separate and independent sale is a matter for decision under the peculiar facts of the particular case. In this regard each case must stand or fall on its own facts." 434 F. 2d at 925.

Although the Securities Exchange Act has been in force for 37 years, the issue presented by this case has never before arisen. Therefore, of course, there exists no conflict between the decision of the Eighth Circuit below and any ruling of this Court or of any other Circuit. Although this case is important to the parties, it contains nothing of general interest or importance because of its circumscription by its own facts. None of the considerations enumerated in this Court's Rule 19 are present to warrant the exercise of this Court's certiorari power or to justify the usurpation by this case of valuable space on this Court's docket.

The unusual predicament in which Emerson found itself inextricably trapped resulted solely from the tender offer and the defensive tactics employed by Dodge and Reliance to thwart Emerson's contemplated marriage to Dodge.

This case arose in 1967, when tender offers were in vogue, primarily because they were unregulated by the Securities and Exchange Commission. In 1968, however, Section 14 of the Act (15 U.S.C., § 78n) was amended to require the

---

[2] See 306 F. Supp. at 591.

filing with the Commission of all tender offers for the stock of registered companies. Since the effective date of these amendments, the tender offer has suffered a marked decline in glamour and popularity. Moreover, the mechanism provided by the 1968 amendments to Section 14 contains safeguards to prevent the emergence of the "corporate triangle," such as the acrimonious Emerson-Dodge-Reliance encounter that caused Emerson's dilemma and precipitated this case.

There is no contention, and there can be none, that Emerson had access to, or in any way capitalized on, any inside information relative to Dodge. If the Court of Appeals was correct in holding that Emerson's initial purchase of 13.2% of Dodge stock subjected it instantaneously to Section 16(b), the impediments inherent in such status are not imposed because of actual privity to inside information but rather because of an arbitrary, but conclusive, presumption of such access. It is an undisputed fact that Emerson was a bitterly resented and repeatedly spurned outsider, as is witnessed by the three lawsuits between Dodge and Emerson. Emerson was a "fiduciary" of Dodge in name only.

It was, in fact, Emerson's lack of voice in Dodge management which enabled Dodge and Reliance to join forces and squeeze Emerson into a quandary, which was occasioned by the scheduled merger of Dodge into Reliance. The exchange of Dodge shares for Reliance shares in the merger would have constituted a "sale" of the Dodge shares owned by Emerson and would presumably have subjected the profits thereon to the forfeiture provisions of Section 16(b).

If it had not been for the impending merger, Emerson probably would have been content to retain its Dodge shares. However, under the circumstances, counsel recommended that Emerson reduce its Dodge holdings to less

than 10% in advance of the Dodge stockholders' meeting scheduled for August 22, 1967.[3]

It was after Emerson's sale of 37,000 shares to Goldman, Sachs had been consummated that *Reliance* broached the subject of Emerson's possible disposition of the remaining shares.

The facts, as found by the District Court and confirmed by the Court of Appeals, conclusively establish that the sale of 37,000 shares to Goldman, Sachs on August 28, and the sale of 115,282 shares to Dodge on September 13, were not "one sale" but were made to different persons, at different times, at different prices, through different mediums, and were separately negotiated by different parties. They were two in form and two in substance.

Reliance's Petition, by implication, ascribes an improper motive to Emerson. But it is clear that neither the District Court nor the Court of Appeals found any such motive. Emerson was simply trying to extricate itself from an adverse predicament not of its own making. If Emerson had misused inside information, Reliance could have pursued it under Section 10 (b) of the Securities Exchange Act. But the question before the Court of Appeals in *this* case was whether the September 13th sale was covered by Section 16(b).

As indisputably revealed by the facts of this case, the issue presented is an esoteric one never before adjudicated and not likely to recur. The Court of Appeals manifestly confined the applicability of its opinion to the unique facts of this case. Other factual nuances, including those hypothesized in Reliance's Petition (p. 8), will have to withstand individual scrutiny if and when they arise.

---

[3] It was subsequently decided that, in view of the provision of the Indiana statutes requiring reapproval of the proposed merger by Dodge directors thirty days after the stockholders' meeting, the sale need not be made prior to August 22.

An additional reason for denying certiorari is that the decision of the Court of Appeals is absolutely correct.

The authors of Section 16(b) recognized the difficulty of proving misuse of inside information, and so they erected arbitrary guidelines to govern transactions by insiders. These guidelines are either observed or they are breached, and the intent of the insider, which is often incapable of ascertainment or proof, will not be examined.

For instance, the Act's six-month holding period is purely arbitrary. There is nothing particularly "magic" about this period of time. Yet Reliance would not contend that if Emerson had held its Dodge stock for six months and one day, simply to avoid the application of Section 16(b), it would be subject to the Act by reason of its intent to avoid liability. It has been specifically held that an insider, even if he notoriously capitalizes on inside information, is not subject to Section 16(b) if he holds his stock for six months and one day.

In *Adler v. Klawans*, 267 F. 2d 840, 845 (2d Cir. 1959), the Court, per Mr. Chief Justice Burger, in speaking of the "harsh" prophylactic nature of Section 16(b), stated as follows:

> "Its bite is sharp only in the limited area of transactions it covers, . . . but for the insider who waits six months and one day after purchase to avoid a short term gain there is no bite at all except as conscience calls the use of inside information on sales after six months as reprehensible as on sales within six months.
>
> * * * * * * *
>
> "Large areas of 'insider' conduct were consciously left untouched by Congress for reasons dictated by practicalities rather than ethics or pure logic. A line had to be drawn somewhere by the lawmakers, as they must do in the laws of marriage, divorce, legitimacy,

real estate, wills and a host of other subjects governed by statute. But the consciously limited scope of the statute is no reason for us to seek yet further limitations of what is remedial legislation."

By the same token, the 10% requirement of Section 16(b) is admittedly arbitrary. As observed above in the quote from *Adler*, "a line had to be drawn somewhere." Persons who are holders of more than 10% are conclusively presumed to be insiders for the purposes of the Act; those with less than 10% at the time of a purchase or sale, no matter how complete their access to inside information, are absolutely exempt from the Act's proscriptions. There is no requirement that one must attain or remain in a 10% status—and therefore be conclusively presumed to be a fiduciary—if he does not desire to do so. He may purchase only 9.9% to obviate the need for filing the reports required by Section 16(a). If he owns more than 10%, he may sell off enough stock to reduce his holdings to less than 10% simply to avoid further regulation by the statute.

There is no contention that Emerson's sale to Goldman, Sachs, which reduced its holdings to less than 10%, was a sham. Emerson without question divested itself of ownership, control and dominion over the 37,000 shares and *ispo facto* ceased to be a statutory insider. It was only after the consummation of the sale that Reliance itself initiated the second sale. It is reasonable to hypothesize that in the absence of Reliance's offer to purchase those remaining shares, Emerson would have been content to exchange them in the merger.

That this type of a situation was not intended to be subjected to Section 16(b) is evident from the following analysis:[4]

---

[4] *Katz*, "Short-Swing Liability" The Review of Securities Regulation, Vol. 2, No. 8 (April 16, 1969).

"[T]he imposition of Section 16(b) liability generally in the context of corporate reorganizations is likely to penalize more innocent persons than those who have gained advantages through actual abuse of insider information. For example, in a period of numerous contests for corporate control by tender offer, unfairness can result if Section 16(b) is automatically applied. Where the management of the target company undertakes a defensive merger with a third company to thwart a tender offer, the tender offeror typically is neither privy to the defensive merger nor apprised of plans for its consummation. Having failed in a bid to gain control through the tender offer, but having obtained enough stock to become a statutory insider, the offeror is locked into securities of a hostile issuer. It may be obliged to dispose of such securities pursuant to a corporate reorganization over which it has no control and with respect to which it obviously has no inside information. *It is fair to say that the imposition of Section 16(b) liability in this context would involve an unjustifiable and probably unintended hardship.*" (Emphasis supplied.)

The proviso to Section 16(b) specifically exempts any transaction in which the owner did not own more than 10% "both at the time of the purchase and sale." It is difficult to conceive of a more explicit exemption for the sale in question here.

As early as 1934, immediately after the passage of the Act, it was recognized that a 10% shareholder could sell enough of his holdings to drop him below 10% and thereafter with impunity, free from the restrictions of Section 16(b), could sell his remaining stock. The Act unequivocally so provides. In *Seligman* "Problems Under the Securities Exchange Act," 21 Va. L. Rev. 1, 20 (1934), the author stated:

> ". . . the intention of the language was to exclude the second sale in a case where 10% is purchased, 5% sold within three months and the remaining 5% a month later. This latter construction of the Act is, it is believed, the only safe one to rely on."

In the only Section 16(b) case ever decided by this Court, *Blau v. Lehman,* 368 U.S. 403 (1962), it was expressly ordered that the Act must be construed as written. This Court observed that if a reading of the plain, unambiguous language of the statute produces what some people might consider to be a "loophole," such matters should be directed to the attention of Congress, not to the courts.[5]

The Court of Appeals analogized Section 16(b) to the tax law, relying on the well-settled principle that a person may conduct his business in a way so as to minimize, or if possible, to eliminate tax liability by any means which the law permits, so long as he does not engage in a sham, subterfuge or fraud. *Helvering v. Gregory,* 69 F. 2d 809 (2d Cir. 1934) *affirmed* 293 U.S. 465 (1935); *United States v. Isham,* 84 U.S. [17 Wall] 496 (1873).

This rule is nothing but a particularization of the universal proposition that every man has the right to conduct his business affairs by all lawful and proper means so as to take advantage of the rights and privileges accorded to him by law, to keep within the limitations, restrictions and prohibitions of the law, and to avoid, by lawful means, the liabilities, forfeitures and penalties imposed by law.

Petitioner erroneously asserts that the decision below is in conflict with *Bershad v. McDonough,* 428 F. 2d 693

---

[5] There is no such "loophole" in the instant case, however, because Emerson was treated exactly the same as any other owner of 9.96% of an issuer's stock. In addition, there is always a remedy available under Section 10(b) to any purchaser or seller who is *actually* victimized by a *true* insider.

(7th Cir. 1970). The *Bershad* case was concerned with determining whether an irrevocable "option" given to a purchaser in consideration for a down-payment of $350,000 was, in effect, a "sale" for purposes of Section 16(b). The Court held that the magnitude of the down-payment, coupled with the seller's granting of an irrevocable proxy to the purchaser and the seller's resignation as an officer and director, insured that the option would be exercised. Thus the Court held "without doing violence to the statute" that the option was a sham and the sale was effectively accomplished as of the "option" date.

The considerations in *Bershad* are inapposite to the instant case. It is *Petitioner's* theory that would require us to "do violence to the statute." Emerson and the Court of Appeals read Section 16(b) to mean exactly what it expressly, unequivocally says.

CONCLUSION

For the reasons stated, the Petition for Certiorari should be denied.

Respectfully submitted,

R. H. McROBERTS

THOMAS C. WALSH
1600 Boatmen's Bank Building
St. Louis, Missouri 63102
Attorneys for Respondent,
Emerson Electric Company

BRYAN, CAVE, McPHEETERS & McROBERTS
Of Counsel